UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF LOUISIANA

IN THE MATTER OF	NUMBER
CHARLES M. RICHARDSON SANDRA P. RICHARDSON	88-11990 SECTION A
DEBTORS	
CHARLES M. RICHARDSON SANDRA P. RICHARDSON	ADVERSARY NUMBER 03-1168
PLAINTIFFS	
V.	
EDUCATIONAL LOAN SERVICING CENTER, INC., et al.	
DEFENDANTS	CHAPTER 11

MEMORANDUM OPINION

Debtors Charles and Sandra Richardson filed chapter 11 in May 1988. After they completed all payments required by the confirmed plan, their reorganization was closed and a final decree was entered in February 1995. This case deals with the Richardsons' liability for student loan debts that were not paid under the plan, even though the student loan creditor filed a timely proof of claim in the Richardsons' chapter 11 case.

For several years after the final decree, the debtors received no statements or bills for the unpaid student loans. However, in 1999 USA Group Loan Services, Inc. notified the debtors that they remained liable for the student loans and demanded payment.

The Richardsons sued for a declaration that the lenders were barred from demanding payment of the two pre-petition student loans. Defendants[1] United Student Aid Funds, Inc., Sallie Mae Servicing Corp. (n/k/a Sallie Mae, Inc.) and Student Loan Marketing Association (collectively "Student Loan Lenders") eventually answered. United Student Aid Funds, Inc. and Sallie Mae Servicing Corp. counterclaimed against the Richardsons for both unpaid principal and all accrued interest on the student loans.

I. FACTS

To pay part of his daughter's college tuition, debtor Charles M. Richardson executed two promissory notes, each for $3,000.00, one on January 27, 1986 and another on February 2, 1986. Both promissory notes unambiguously provide for interest on the unpaid principal at the rate of 12% per annum.[2] The uncontradicted evidence at trial was that the interest rate was fixed, and did not vary.

The Richardsons filed their chapter 11 petition on May 12, 1988. Student Loan Marketing Association filed a proof of claim for $5,367.18 on June 28, 1988, and on July 11, 1988 filed a notice that it had assigned the claim to United Student Aid Funds. The court approved the assignment on August 4, 1988. The Richardsons' plan of reorganization was confirmed July 25, 1989. Unfortunately, the debtors' plan did not provide for payment of the student loans. The court issued a final decree in the reorganization on January 17, 1995 and closed the case on February 7, 1995. The court's

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[1] Student Loan Marketing Association is the successor-in-interest to defendants USA Group Loan Services, Inc., Educational Loan Servicing Center, USA Group, Inc., USA Services, Inc. and USA Education, Inc. The United States Department of Education was dismissed from the proceeding on August 1, 2003 on *ex parte* motion of plaintiffs. USA Services, Inc. also was dismissed on January 8, 2004 on the plaintiffs' *ex parte* motion.

[2] Promissory Notes (Defendants' Exhibits 1 & 2).

records reflect service of notice of the final decree on Educational Loan Servicing Center[3] and Student Loan Marketing Association the same month.

Mr. Richardson testified at trial that he believed that all his prepetition debts had been paid by the date the final decree was entered. He also testified that his bankruptcy lawyer (who was not his trial counsel in this case) never explained to him that student loan debts were not dischargeable in his chapter 11 case.

The debtors stopped receiving regular statements from the Student Loan Lenders shortly after filing bankruptcy, although in November 1988 Mr. Richardson received a statement from Educational Loan Servicing Center indicating that his account had been paid in full.[4] Ruth Hankins, a litigation assistant for Sallie Mae, Inc., testified at trial that this statement showed balance owed on the account because USA Funds, the guarantor, had purchased the account from loan servicer USA Group (formerly Educational Loan Services Center) pursuant to the student loan guaranty. In any case, the account was repurchased by the loan servicer in April 1999, after which the servicer resumed contacting the Richardsons about repayment of the student loans.

Ms. Hankins of Sallie Mae explained only a part of the lenders' delay in resuming efforts to collect the debt until nearly four and a half years after the final decree. She believed the automatic stay barred collection activity until the entry of a final decree.[5]

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[3] The postal service returned the notice to Educational Loan Servicing Center with the stamp "Forwarding Order Expired."

[4] See statement dated November 4, 1988 (Defendants' Exhibit 6). Mr. Richardson testified that he relied on the statement, which reflected that no further balance was due. However, the statement also showed credit for a June 30, 1988 payment of $5471.28. The evidence showed that the Richardsons did not make that payment, which actually came from the student loan guarantor. Mr. Richardson's claim that he relied on the statement is not reasonable in light of this evidence.

[5] In fact, the automatic stay under 11 U.S.C. §362 only continues until a discharge is granted. 11 U.S.C. §362(c)(2)(C). Thereafter, in a chapter 11 case (in which debts are discharged upon confirmation of a plan)

The Student Loan Lenders offered no evidence to explain their four year delay (from 1995 until 1999) in resuming collection efforts, although Ms. Hankins did testify that the lenders were not notified by the court, the Richardsons or their lawyer that the bankruptcy case had been "discharged" until April 1999.[6]

After some attempts to dissuade the lenders from pursuing collection of a debt they believed discharged, the debtors re-opened their bankruptcy in mid-2002 to seek a decree that the defendants were estopped from demanding payment of the student loans**.** After a further unexplained delay of nearly one year, on June 13, 2003, the debtors filed this lawsuit.

On July 27, 2004, Chief Judge Brahney ruled on the Student Loan Lenders' motion for summary judgment that the student loans were nondischargeable debts. However, he denied summary judgment on the issue of quantum. The undersigned denied defendants' summary judgment on quantum on February 15, 2005.

After much unproductive quarreling before trial concerning the applicable interest rate and principal balance,[7] the parties eventually agreed that the principal balance was $5,367.18. The only issue tried was whether the Richardsons owed any interest on the debt.

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the post-discharge injunction comes into existence pursuant to 11 U.S.C. §1141(d)(1)(A). After confirmation in a chapter 11 case, there is no discharge injunction applicable to nondischargeable debts. See footnote 7, below. Because the Richardsons' student loan debt is non-dischargeable, the defendants could have pursued its collection from non-estate property after confirmation in 1989. *Dolven v. Bartleson* (*In re Bartleson)*, 253 B.R. 75, 81 (9th Cir. B.A.P. 2000).

[6] See SLMA Delinquency Screen Report (Defendants' Exhibit 7).

[7] For example, at the February 15, 2005 hearing on defendants' motion for summary judgment on the issue of quantum, counsel for the former debtors insisted that a material disputed fact existed concerning the interest rate applicable to the loans. At trial, however, Mr. Richardson himself admitted that he has no reason to dispute that the 12% interest rate specified in the notes has not changed since he signed them.

II. ANALYSIS

A. The Debtors' Liability for Unpaid Interest is not Dischargeable

Confirmation of a plan does not discharge an individual debtor from debts for student loans unless the debtor proves that paying the debt would be an undue hardship. 11 U.S.C. §§1141(d)(2) and 523(a)(8). The court already has ruled that the principal portion of the debt is nondischargeable.

In *Bruning v. United States*, 376 U.S. 358, 84 S. Ct. 906, 11 L.Ed.2d 772 (1964), a decision under the earlier Federal Bankruptcy Act, the United States Supreme Court considered whether a discharged debtor remained personally liable for interest on a tax debt that survived his bankruptcy. The court reasoned that "interest is considered to be the cost of the use of the amounts owing to a creditor and an incentive to prompt repayment and, thus, an integral part of a continuing debt." 376 U.S. at 360, 84 S. Ct. at 908. In light of Congress's clear intent that personal liability for the principal amount of unpaid tax debts survives bankruptcy, the Supreme Court held that the Bankruptcy Act provided "no reason to believe that Congress had a different intention with regard to personal liability for the interest on such debts." 376 U.S. at 361, 84 S. Ct. at 908.

Courts have reasoned from *Bruning* that interest on student loan obligations is not dischargeable. *Leeper v. Pennsylvania Higher Education Assistance Agency*, 49 F.3d 98, 102, 105 (3d Cir. 1995) (interest accrued on unpaid student loan obligation not dischargeable). The Third Circuit in *Leeper* also has concluded that the reasoning of *Bruning* is "equally applicable to cases under the Bankruptcy Code." *Id*. at 104. *See also In re Kielisch*, 258 F.3d 315, 318 n.1, 321 (4th Cir. 2001) (debtor remains liable for

interest on non-dischargeable student loan debt, which is not "frozen," but continues to accrue after bankruptcy filing); *In re Sullivan*, 195 B.R. 649, 653 (Bankr. W.D. Tex. 1996) (debtor remains liable post-discharge for nondischargeable post-petition interest accruing on student loan claim).

Accordingly, the Richardsons' nondischargeable liability for the student loan obligation includes both pre- and post-petition interest on the promissory notes.

B. The Debtors are not Entitled to Equitable Relief

Debtors urge the court to rely on 11 U.S.C. §105(a) to bar the Student Loan Lenders from collecting all the interest to which they otherwise would be entitled by the terms of the notes. Specifically, debtors argue that the equitable doctrine of laches should reduce or defeat the Student Loan Lenders' recovery because they allowed interest to accrue for many years without demanding payment from the debtors. The Richardsons' argument has some appeal, if only because the Student Loan Lenders have offered no convincing justification for their four year delay in resuming collection efforts after the Richardsons' chapter 11 case closed (much less any reason for not trying to collect from the debtors as early as 1989, when the debtors' chapter 11 plan was confirmed).[8] However, the plea must be rejected because a federal statute providing for time limits for actions to collect student loans bars the defense of laches.

[8] From the date the chapter 11 was filed until the debtors' plan was confirmed on July 25, 1989, the automatic stay of 11 U.S.C. §362 prevented the Student Loan Lenders from actions to collect the student loans. However, there is no evidence in the record that the debtors sought an injunction of post-confirmation collection activity by the Student Loan Lenders. "In order to obtain the benefits of [the] discharge injunction with respect to a nondischargeable debt, the debtor must specifically request one.… Sections 1141 and 524, read together, indicate that a party holding a non-dischargeable debt has the right to pursue collection of that debt." *Dolven v. Bartleson (In re Bartleson)*, 253 B.R. at 81. Thus, the lenders could have pursued collection as early as 1989, after the plan was confirmed.

The statute of limitations for federal student loans is set out in 20 U.S.C. §1091a. That statute provides in relevant part:

> (1) It is the purpose of this subsection to ensure that obligations to repay loans and grant overpayments are enforced without regard to any Federal or State statutory, regulatory, or administrative limitation on the period within which debts may be enforced.
>
> (2) Notwithstanding any other provision of statute, regulation, or administrative limitation, no limitation shall terminate the period within which suit may be filed, a judgment may be enforced, or an offset, garnishment, or other action initiated or taken by—
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> (A) an institution that receives funds under this subchapter and part C of subchapter I of chapter 34 of Title 42 that is seeking to collect a refund due from a student on a grant made, or work assistance awarded, under this subchapter and part C of subchapter I of chapter 34 of Title 42;
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> (B) a guaranty agency that has an agreement with the Secretary under section 1078(c) of this title that is seeking the repayment of the amount due from a borrower on a loan made under part B of this subchapter after such guaranty agency reimburses the previous holder of the loan for its loss on account of the default of the borrower;
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> (C) an institution that has an agreement with the Secretary pursuant to section 1087c or 1087cc(a) of this title that is seeking the repayment of the amount due from a borrower on a loan made under part C or D of this subchapter after the default of the borrower on such loan.…

According to our court of appeals, "§ 1091a eliminates all limitations defenses for collection of student debts." *U.S. v. Lawrence*, 276 F.3d 193, 196 (5th Cir. 2001). In fact, the Fifth Circuit specifically held in *Lawrence* that "1091a also extends to eliminate the equitable defense of laches." *Id*. Thus, debtors' laches defense fails as a matter of law.[9]

Mr. Richardson offered no evidence to support the conclusion that as a matter of law, he and his wife should be relieved from the consequences of not paying the loans

[9] Bankruptcy courts cannot disregard substantive law in the name of equity. *See Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 24-25, 120 S. Ct. 1951, 1957 (2000).

according to the notes' terms. Thus, the Richardsons' good faith (or lack of good faith) in failing to pay the obligations before the lenders resumed collection efforts in 1999[10] is irrelevant.

C. The Debtors are not Entitled to a Hardship Discharge

The Richardsons did not specifically raise the defense of hardship discharge in any of their pleadings. However, in post-trial briefs, for the first time in this adversary proceeding, the parties referred to the possibility that the Richardsons may be entitled to a hardship discharge of some of the unpaid interest. The Student Loan Lenders objected to the debtors' belatedly raising the possibility of undue hardship in their post-trial brief.[11]

The Richardsons offered no justification for failing to raise hardship discharge in either the complaint or their response to the Student Loan Lenders' motion for summary judgment. Nor did they raise the issue of undue hardship as an affirmative defense to the counterclaim of United Student Aid Funds, Inc. and Sallie Mae Servicing Corp.[12]

By failing to urge entitlement to a hardship discharge until the final post-trial briefing, the debtors waived the hardship discharge defense. *Woodfield v. Bowman*, 193 F.3d 354, 362 (5th Cir. 1999) ("The Federal Rules require an affirmative defense to be pleaded; failure to plead such a defense constitutes waiver.") Moreover, the court declines to exercise its discretion to allow an amendment to the pleadings at this stage. Allowing the amendment after trial obviously would prejudice the Student Loan Lenders, who lacked "'fair notice' of the defense that [was] being advanced," *id*. at 362, in time to

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[10] Schedule of Correspondence (Plaintiffs' Exhibit 15).

[11] Defendants' Reply to Plaintiffs' Post-trial Brief (Pleading 74).

[12] Plaintiffs' Answer to Counter-claim of United Student Aid Funds, Inc. and Sallie Mae Servicing Corp. (Pleading 19).

counter the Richardsons' claims at trial.[13] *See also Flannery v. Carroll*, 676 F.2d 126, 131-132 (5th Cir. 1982) (affirming denial of plaintiffs' post-verdict motion to amend pretrial order to include claim not urged to jury as "manifestly unjust" to defendant).

In any case, even if the Richardsons had preserved the issue of entitlement to a hardship discharge, they failed to prove that they are entitled to a discharge on that ground.

The reasoning of *Brunner v. New York State Higher Education Services Corp.*, 831 F.2d 395 (2d Cir. 1987), which was embraced by the Fifth Circuit in *In re Gerhardt*, 348 F.3d 89 (5th Cir. 2003), requires a three-part showing to discharge a student loan obligation on the ground of undue hardship:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans;
>
> (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and
>
> (3) that the debtor has made good faith efforts to repay the loans.

831 F.2d at 396.

The Richardsons offered absolutely no evidence demonstrating that they have met the *Brunner* test. Therefore, plaintiffs have not proven that they are entitled to a discharge of any portion of their obligation on the basis of undue hardship.

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[13] Federal Rule of Civil Procedure 15(b), made applicable to this proceeding by Federal Rule of Bankruptcy Procedure 7015, allows "amendments to conform to the evidence" when "issues not raised by the pleadings are tried by express or implied consent of the parties." This rule is inapplicable because the Richardsons did not present any evidence of undue hardship at the trial.

D. Principal Amount

At the February 15, 2005 hearing on the Student Loan Lenders' motion for summary judgment on quantum, the parties agreed that the principal balance on the notes was $5,367.18. Despite that, the Student Loan Lenders' amortization schedule[14] admitted into evidence at trial shows the principal balance as $8,564.56 as of March 21, 2005. Ms. Hankins's testimony suggested that the difference is attributable to interest accrued over some part of the time during which the Richardsons' bankruptcy was pending. The Student Loan Lenders treated the bankruptcy as a "deferment" under the notes and capitalized the accrued interest, adding it to the principal balance pursuant to section III of the promissory notes.[15]

The Richardsons contend[16] that nothing in the notes allows the Student Loan Lenders to increase the principal amount in that fashion. The Student Loan Lenders' post-trial briefs did not address capitalization of accruing interest.

The promissory notes do not specifically state that bankruptcy is treated as a "deferment." Neither section III of the promissory notes, captioned "Interest," nor section VIII, captioned "Deferment," mentions bankruptcy. Absent any evidence or indication in the notes that a bankruptcy case is treated as a "deferment," the agreed upon $5,367.18 is the principal balance for purposes of calculating the interest owed to the Student Loan Lenders.

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[14] Amortization schedule (Defendants' Exhibit 3).

[15] Promissory notes (Defendants' Exhibits 1 and 2).

[16] Complainants' Reply to Defendants' Post-Trial Brief (Pleading 75), p. 2.

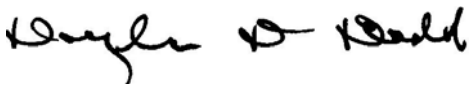
Conclusion

Through no fault of their creditors, the debtors failed to include provisions in their confirmed chapter 11 plan for paying a timely proof of claim for nondischargeable student loans. Over the course of seventeen years since the Richardsons filed chapter 11 (six of which have passed since the lenders first contacted the Richardsons about resuming repayment), accruing interest has caused a relatively modest loan balance to mushroom into a much larger obligation. However, neither the law nor the record of this case justifies relieving the Richardsons from paying any part of the student loan obligation, including the accrued interest.

Accordingly, the Richardsons' obligation to pay unpaid principal in the amount of $5,367.18, plus both pre-petition and post-petition interest on the two promissory notes accruing at the rate of twelve percent per annum from January 27, 1986 and February 2, 1986, through June 20, 2005, is nondischargeable.

The notes provide that the prevailing party is entitled to attorney fees and costs. The Student Loan Lenders are directed to file a motion for attorney fees and costs with supporting documentation within ten days of the entry of judgment, and notice the motion for hearing pursuant to the rules of this Court.

New Orleans, Louisiana, June 20, 2005.



Douglas D. Dodd
U.S. Bankruptcy Judge